PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

December 5, 2002 **Alternate to Agenda ID # 623**

TO: PARTIES OF RECORD IN RULEMAKING # 93-04-003 & INVESTIGATION # 93-04-002.

Enclosed is the Alternate Draft Decision of Commissioner Brown to the Draft Decision of Administrative Law Judge (ALJ) Jones previously mailed to you.

When the Commission acts on the draft or alternate decision, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Public Utilities Code Section 311(e) requires that an alternate to a draft decision be served on all parties, and be subject to public review and comment prior to a vote of the Commission. Rule 77.6(d) provides that comments on the alternate draft decision be filed at least seven days before the Commission meeting.

Please note that the alternate decision makes only one change to the ALJ's draft decision; a footnote is added near the beginning of the discussion section. Also note that the attachments to the draft decision are also applicable to this alternate decision.

Comments on the alternate decision must be filed and served Thursday, December 12, 2002. Reply comments must be filed and served by Tuesday, December 17, 2002.

Pursuant to Rule 77.3 comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ CAROL A. BROWN
Carol A. Brown, Interim Chief
Administrative Law Judge

CAB:vfw

Attachment

Decision ALTERNATE DRAFT DECISION OF COMMISSIONER BROWN
(Mailed 12/5/2002)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks.	Rulemaking 93-04-003 (Filed April 7, 1993)
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	Investigation 93-04-002 (Filed April 7 1993) (**Permanent Line Sharing Phase)**

INTERIM OPINION ESTABLISHING A PERMANENT RATE FOR THE HIGH-FREQUENCY PORTION OF THE LOOP

(See Appendix A for a List of Appearances)

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INTERIM OPINION ESTABLISHING A PERMANENT RATE FOR THE HIGH-FREQUENCY PORTION OF THE LOOP

1. Summary

In this decision, we exert our independent state authority under Public Utilities Code § 709.7 to order Pacific Bell Telephone Company (Pacific) and Verizon California Inc. (Verizon) to offer the line sharing Unbundled Network Element (UNE). We adopt a permanent UNE rate for the High-Frequency Portion of the Loop (HFPL)[1] of $0 for both Pacific and Verizon.

The Interim Line Sharing (ILS) decision determined that there should be a true-up from the interim rates adopted in the ILS proceeding, and the final rates adopted in this Permanent Line Sharing Phase. The ILS proceeding established memorandum accounts to track the revenues from the purchase of the HFPL by Competitive Local Exchange Carriers (CLECs). Since a rate of $0 is adopted for the HFPL, Pacific is required to refund the revenues from the $5.85 monthly recurring rate, and Verizon, the $3.00 monthly recurring rate adopted in the ILS proceeding, to the CLEC that purchased each loop.

Our interest is in encouraging the availability of affordable broadband services to California consumers. As a policy, we wish to encourage competition in residential DSL offerings because today there is a lack of affordable, ubiquitously available broadband service options provided by alternative cable modem, satellite and wireless technologies. Until such time that comparatively

[1] The High Frequency Portion of the Loop is that portion used to carry high bandwidth services such as Digital Subscriber Line service (DSL). This is in contrast to the low frequency portion of the loop used to carry voice grade services.

affordable, competitive broadband alternatives are widely available to residential consumers, line sharing should continue to be offered as a UNE.

2. Background

On December 9, 1999, the Federal Communications Commission (FCC) released a decision requiring incumbent local exchange carriers (ILECs) to allow CLECs access to the high frequency portion of the local loop.[2] In its order, the FCC finds that the high frequency portion of the loop meets the statutory definition of a network element, and must be unbundled pursuant to §§ 251(d)(2) and 251(c)(3) of the Federal Telecommunications Act of 1996 (TA96 or Act).

The FCC order strongly encourages states to issue interim arbitration awards setting out the necessary rates, terms, and conditions for access to this unbundled network element (UNE), with any unresolved issues subject to a true-up adjustment when the state commission completes its arbitration. The FCC urges states to issue these awards as quickly as possible after a party petitions for arbitration under the Act, so that CLECs may begin providing advanced services on shared loops by June 6, 2000 (i.e., within 180 days of release of its order). (Line Sharing Order, ¶ 160.)

The Commission opened a new phase of the Open Access and Network Architecture Development (OANAD) proceeding to establish terms and conditions for access to the HFPL. The Commission also determined that the line sharing portion of OANAD would proceed in two phases; the interim arbitration phase concluded in September 2000 with Commission Decision (D.) 00-09-074,

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[2] Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket Nos.98-147 and 96-98, FCC 99-355, Third Report and Order in CC Docket No. 98-147 and fourth Report and Order in CC Docket No. 96-98, Released December 9, 1999, (Line Sharing Order).

with further proceedings to be scheduled for the purpose of setting final rates, and addressing other line sharing issues, with all interim rates subject to true-up adjustment.

Ordering Paragraph 2 of D.00-09-074 indicated that the permanent line sharing phase of this proceeding would determine:

a. final prices, including the issue of double recovery of loop costs and disposition of balances in memoranda accounts;

b. the number of tie cables in an efficient line sharing configuration;

c. whether or not to continue the limitation on decommissioning copper local loop plant pending resolution of line sharing or transport over fiber facilities; and

d. other issues only to the extent specifically added by the ALJ (Administrative Law Judge).

At a Prehearing Conference (PHC), held on May 2, 2001, the assigned ALJ set a procedural schedule for the "permanent" line sharing (PLS) proceeding. She bifurcated the proceeding, and put the issue of a permanent price for the HFPL on a separate expedited track. A separate schedule was developed for the other so-called "noncosting issues." Pursuant to the schedule for the HFPL phase, parties submitted opening and rebuttal testimony in June 2001 on the issue of an appropriate price for access to the HFPL. Additionally, parties addressed whether, if the Commission retains a positive price for access to the HFPL, any portion of that price should be refunded to customers.

On July 2, 2001, parties filed briefs on the need for hearings. Parties agreed that the issue of the price for the HFPL was largely a policy issue, and hearings were not required. At the request of all active parties, on August 2, 2001, at a hearing in the noncosting phase, all the prefiled testimony in the HFPL phase was deemed to have been entered into evidence. Since parties concurred that no hearings were necessary, they agreed to waive the right to cross-examine witnesses. Opening briefs were filed on July 28, 2001, and Reply Briefs, on August 20 and August 27, 2001.

3. The D.C. Circuit's USTA[3] Decision Does Not Preclude This Commission from Setting Permanent Rates for the HFPL

3.1 Background

On May 24, 2002, after the Draft Decision (DD) in this proceeding was released for comments, the D.C. Circuit Court vacated and remanded the FCC's Line Sharing Order. In its review of the Line Sharing Order, the Court found that the FCC , in ordering unbundling of the HFPL to enable CLECs to provide DSL services, failed to consider the relevance of competition in broadband services coming from cable and, to a lesser extent, satellite.

The Court cited information from the FCC's series of § 706 reports[4] that there is robust competition in the broadband market, and the market is dominated by cable modem service. As of the end of June 2001, cable companies had 54% of extant high-speed lines, almost double the 28% share of asymmetric DSL. In its pleadings before the Court, the FCC indicates that it focused solely on DSL because that is what "CLECs seek to offer when they request line sharing." The Court concludes that the FCC adopted the Line Sharing Order with indifference to petitioners' contentions about the state of competition in the market. Verizon filed a motion to suspend the comment period on the DD on

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[3] United States Telecom Association v.FCC, Case No. 00-1012, 2002 WL 1040574 (D.C. Cir. May 24, 2002) (USTA).

[4] Section 706 of the Act requires the FCC and state commissions to encourage the deployment of advanced telecommunications capability. The FCC has issued several reports on the status of deployment, the so-called "706 reports."

May 24, 2002, the same day that the D.C. Circuit issued its opinion. Verizon stated that in light of that development, all parties to the docket needed an opportunity to carefully assess their respective positions. There was no time to conduct this assessment before comments were due on the DD. Therefore Verizon asked the Commission to suspend the current running of the comment period on the DD and not to put the DD on the Commission's meeting agenda until further notice. Verizon also filed a motion to shorten time to respond to May 28, 2002, the date set for filing comments on the DD. The assigned ALJ set a revised comment schedule on the DD, through an e-mail to parties on May 28, 2002. Opening comments were filed on June 7, 2002 and Reply Comments, on June 14, 2002. The ALJ allowed 30 pages for each filing to ensure that parties could adequately address both the DD and the D.C. Circuit's opinion.

3.2 Parties' Positions

Verizon and Pacific urge the Commission to hold in abeyance any further consideration of HFPL pricing. According to Pacific, when the D.C. Circuit's mandate issues, the FCC's rules classifying the HFPL as a UNE are null and void, and there will be no lawful basis for requiring Pacific to provide the HFPL to CLECs as a UNE, and no legal basis for setting a permanent price for the HFPL at this time.

Pacific asserts that since the FCC is charged in the first instance with implementing the provisions of §§ 251 and 252 of the Act, including the impairment requirement of § 251(d)(2), there is no state or federal law basis for the Commission to unbundle the HFPL or to price it as a UNE, until the FCC issues new unbundling rules in accordance with the dictates of USTA.

Pacific states that the Commission accepted as a given the FCC's classification of the HFPL as a UNE under the analysis performed by the FCC in its Line Sharing Order, and did not conduct any kind of impairment analysis of the HFPL.

Pacific points out that in light of USTA, FCC Chairman Michael Powell has indicated that the FCC will address the new issues raised by USTA in its reexamination of its unbundling rules and framework in the Triennial Review UNE Rulemaking. According to Pacific, when reexamining the issue of what network elements should be subject to unbundling, the FCC will have to adopt a more rigorous and narrow version of the impair test. The FCC will utilize that more rigorous version of the impair test to determine whether the HFPL should be unbundled at all.

Both Pacific and Verizon urge the Commission to preserve the status quo, pending FCC action to develop a revised "impair" test and issue new unbundling rules. In the interim, both ILECs indicate that they will meet their current line sharing obligations until the uncertainty surrounding the D.C. Circuit opinion is resolved.

The Coalition[5] filed in opposition to Verizon's motion to suspend the comment period on the DD establishing permanent rates for the HFPL, and urged the Commission to issue an order setting permanent rates for the HFPL UNE. According to the Coalition, contrary to Verizon's assertion, the FCC's Line Sharing Order is not the sole source of Verizon's obligation to provide line sharing UNEs to CLECs. The Coalition points out that Verizon is under a continuing obligation until June 2003 under the merger conditions imposed by the FCC in the Bell Atlantic / GTE merger to provide line sharing to CLECs, until

[5] The Coalition includes WorldCom, Inc., AT&T Communications of California, Inc. (AT&T), Covad Communications Company (Covad), the Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN).

the date of any final and non-appealable judicial decision that determines that Bell Atlantic/GTE is not required to provide the line sharing UNE at cost-based rates. Moreover, the Coalition asserts that the FCC has stated unequivocally that "[w]hile we continue to evaluate the Court's opinion and consider all the Commission's options, in the meantime, the current state of affairs for access to network elements remains intact."[6]

The Coalition states that Verizon's Motion to Suspend is premature because the D.C. Circuit's Opinion cannot become effective until the D.C. Circuit issues its Mandate, which will not occur until after July 8, 2002. If parties to the Court's Judgment seek rehearing of the D.C. Circuit's Opinion, it would automatically stay the mandate until disposition of the petition or motion."[7]

The Coalition asserts that the Commission has authority under FCC Rule 51.317 and the California Public Utilities (PU) Code to require line sharing and to set an HFPL rate in California. This authority is independent of the FCC's Line Sharing Order.

According to the Coalition, reviewing courts have repeatedly upheld this broad interpretation of the independent unbundling and ratemaking authority of state commissions. At the highest level, the U.S. Supreme Court reviewed and implicitly approved independent state authority pursuant to Rule 51.317. In AT&T Corp. v. Iowa Utilities Bd., the Supreme Court noted that "[I]f a

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[6] Statement of Chairman Michael Powell, available at www.fcc.gov/Speeches/Powell, Statements/2002/stmkp212.html.

[7] FED.R. APP. PROC. 41(d)(1).

requesting carrier wants access to additional elements, it may petition the state commission, which can make other elements available on a case-by-case basis."[8]

In addition, the Coalition points to P. U. Code § 709.7 which directs the Commission to "expeditiously examine" line sharing and, if appropriate, adopt unbundling requirements for ILECs, even if the FCC did not issue an order for line-shared loops.

The Coalition asserts that they demonstrated in their opening and reply briefs that CLECs are impaired without access to the line sharing UNE under all ten factors set forth in FCC Rule 51.317(b)(2)-(3). If, however, the Commission decides that it needs additional facts to enter an independent finding that CLECs are impaired without access to the HFPL UNE, the Commission should order a limited reopening of this proceeding for the purpose of admitting evidence on the expanded impair standard enunciated by the D.C. Circuit's Opinion.

The Coalition stresses the need for continuation of line sharing during any limited remand of the line sharing issues. CLECs currently provide DSL-based service on line-shared loops to more than one million customers in California. Disconnection of those circuits would be an economic and regulatory nightmare. The Coalition urges the Commission to use its general regulatory authority to require Pacific and Verizon to continue providing line sharing during the pendancy of the limited remand.

In addition, the Coalition indicates that other states have exercised authority to establish additional UNEs. The Minnesota PUC used its authority to

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[8] AT&T Corp. v. Iowa Utilities Bd., 525 U.S. 366, 388 (1999) (IUB). While the Supreme Court remanded FCC Rule 51.319 (the necessary and impair standard) back to the FCC for further justification, it did not remand or note any disfavor with FCC Rule 51.317.

order unbundling of line sharing before the FCC did.[9] The Coalition also cited instances where the Texas PUC has exercised its authority to order unbundling of additional UNEs. The Texas PUC determined that local switching should be available to CLECs on an unbundled basis without restriction, as should operator service and directory assistance.[10]

3.3 Discussion

According to Pacific and Verizon, as a result of the D.C. Circuit's Opinion, there is no legal justification for requiring the ILECs to provide the HFPL to CLECs as a UNE, and correspondingly no lawful basis for setting a permanent UNE-based price for the HFPL until the FCC issues a new "impair" test and new unbundling rules. According to the ILECs, those new FCC unbundling provisions will determine whether the ILECs can be legally required to unbundle the HFPL in the future. We find Pacific's assertions that the HFPL is no longer classified as a UNE or subject to UNE pricing rules to be premature, in light of the fact that the line sharing order is still in effect.

On September 4, 2002 the Court denied World Com, Inc.'s petition for rehearing and also ordered that the vacatur of the Line Sharing Order be stayed until January 2, 2003. Therefore, the FCC's line sharing order is not vacated, and continues to apply as a matter of law. As a practical matter, however, SBC has committed to complying with the order until the FCC reconsiders its rules and

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[9] In the Matter of a Commission Initiated Investigation into the Practices of Incumbent Local Exchange Companies Regarding Shared Line Access; Docket No. P-999 / CI-99-678 (Oct. 8, 1999).

[10] Reply Comments of the Texas PUC, at 2 (citing Petition of MCIMetro Access Transmission Services LLC for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996, Docket No. 24542 (May 1, 2002).

issues a further order. For its part, Verizon is bound by the line sharing order pursuant to a merger agreement which requires Verizon to comply with all FCC orders until there is a final, non-appealable judicial determination. Accordingly, until the FCC issues a further order which becomes final, for the foreseeable future the incumbent LECs will continue to offer line sharing as a UNE. And since line sharing is a UNE, states have the authority to adjust the rates for that UNE. This is similar to the situation states encountered following the Eighth Circuit's opinion in Iowa Utilities Board v. FCC in which the Court concluded that the FCC lacks jurisdiction to issue its pricing rules, and vacated the FCC's pricing rules, and put the TELRIC methodology that states had followed in question. In the interim period until the U.S. Supreme Court reversed the Eighth Circuit,[11] the states continued to use the TELRIC methodology to price UNEs.

At issue here then is whether the CPUC may set a permanent rate for this UNE. We believe that it can, pursuant to AT&T Corp. v. Iowa Utils Board, 525 U.S. 366 (2000). In that case, the Supreme Court made clear that the Act maintains the states' authority to prescribe specific rates for UNEs so long as the rates comport with the federal pricing methodology. (525 U.S. at 384.)

States may also prescribe line sharing as a UNE pursuant to independent state authority. Under 47 C.F.R. § 51.317, the FCC expressly gave the states discretion to require an incumbent LEC in a given market to adopt additional UNEs to further the pro-competitive goals of the Act. Section 251(d)(3) of the Act itself expressly directs the FCC not to preclude the enforcement of any regulation, order, or policy of a state commission that supplements or

[11] Verizon Communications Inc. v. FCC et al., 122 S. Ct. 1646 (2002).

complements federal rules.[12] Congress further provided in sections 261(b) & (c) that states could impose requirements "necessary to further competition in the provision of telephone exchange service or exchange access" so long as the such requirements are not inconsistent with the Act or the FCC's regulations implementing it. See also MCI Telecommunications Corp. v. U.S. West Communications, 204 F.3d 1262, 1265 (9th Cir.), cert denied, 531 U.S. 1001 (2000) (citing section 261(c) for state authority to impose additional requirements consistent with the Act and that further competition); In re Petition of Verizon New England, 2002 Vt. LEXIS 12 (Vt. Supreme Court, Feb. 22, 2002) (same). In short, both the FCC and Congress envisioned that the states, pursuant to state law, could adopt regulations, orders and policies independent of the Act, so long as such regulations, orders, and policies are not inconsistent with or do not otherwise substantially prevent implementation of the requirements of the Act.

As AT&T stated in its comments on the Revised Draft Decision (RDD), the Act, the FCC's Rules and authoritative Court decisions all recognize that the FCC's unbundling determinations constitute a floor, and that states may build upon those determinations to establish additional obligations under both federal and state law. In fact, according to AT&T, the FCC's pre-emptive authority over state authority is extremely limited. Section 251(d)(3)—entitled "Preservation of State Access Regulations"—expressly states that "the Commission [FCC] shall

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[12] Section 251(d)(3) provides: "In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that (A) establishes interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent the implementation of the requirements of this section and the purposes of this part."

not preclude the enforcement of any regulations, order or policy of a State commission that establishes access and interconnection obligations of local exchange carriers," as long as those obligations are "consistent with the requirements of [§ 251] and do not "substantially prevent implementation of § 251] and the purpose of this part" (47U.S.C. § 261(d)(3)). AT&T also notes that this was confirmed in the UNE Remand Order.

AT&T notes that the RDD applies the state's independent authority to find that the HFPL in California meets the FCC's "necessary and impair" standard. However, the "necessary and impair" standard under § 251(d)(2) is not even binding on the states. According to AT&T, the "necessary and impair' standard that limits the FCC's unbundling rules, has no bearing on the states' authority under § 251(d)(3). By its plain terms, § 251(d)(2) does not apply to the states; it applies only to the FCC, and states therefore cannot "violate" it. The states' unbundling decisions are governed by § 251(d)(3), which expressly permits them to adopt additional "access and interconnection obligations" pursuant to state law, and thus without regard to the federal "necessary" and "impair" standards. According to AT&T, § 251(d)(3) expressly holds the states to a different, less stringent standard.

AT&T also states that the U.S. Supreme Court reviewed and implicitly approved independent states authority pursuant to FCC Rule 51.317. In AT&T Corp. v. Iowa Utilities Bd. (525 U.S. 366, 388 (1999)), the Supreme Court stated: "[i]f a requesting carrier wants access to additional elements it may petition the state commission, which can make other elements available on a case-by-case basis."

The Coalition appended comments filed by this Commission at the FCC in its proceeding to review unbundling obligations of ILECs, and we take official notice of those comments. This Commission is on record at the FCC that it should continue to require the ILEC to provide access to the HFPL to enable line sharing.[13] We based our position, at least in part, on the following information about the broadband service market in California:

> In addition, more California customers are served by Pacific Bell / SBC's DSL service than by competing cable modem services, and SBC's market share is growing. Currently, in California, there are 735,677 ADSL lines and 609,174 cable lines provided by both ILECs and CLECs. The vast majority of the ADSL lines are provided by Pacific Bell / SBC.[14] And significantly, 11 million Californians, or one-third of all Californians, live in cities where DSL service is the only choice for broadband service.[15]

In the CPUC's Comments, we concluded that alternative technologies to an ILEC's broadband service are not ubiquitously available. Broadband cable service is limited to areas where the cable plant has been upgraded, but due to the high cost of upgrades, service is provided only in suburban residential communities with some spotty coverage in downtown areas.[16]

Based on our analysis of the broadband market in California, we can reasonably conclude that in California *wholesale* markets, line sharing is the only viable option for a CLEC who seeks to compete with the incumbent LEC in

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[13] Comments of the People of the State of California and the California Public Utilities Commission, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338, April 5, 2002 "CPUC Comments."

[14] CPUC Comments citing In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability, Third Report, FCC 02-33 (February 6, 2002).

[15] This data was provided by California ILECs and the California Cable and Telecommunications Association to the CPUC.

[16] CPUC Comments at 12.

providing DSL service to residential consumers. This is because, CLEC purchase of dedicated conditioned loops are typically uneconomic for provisioning DSL to residential consumers. Further, under current FCC regulations, a CLEC has no right of access to the high-speed transmission component of cable modem service, the functional equivalent of DSL service. Accordingly, we conclude that a CLEC cannot compete effectively in the broadband market unless the CLEC has access to line sharing.

Additionally, retail broadband offerings to residential consumers are limited. Wireless broadband is in its infancy and is not widely deployed. Broadband satellite offerings are more expensive than retail DSL offerings and cable modem availability is relatively limited at this time. As a policy, we wish to encourage competition in residential DSL offerings because today there is a lack of affordable, ubiquitously available broadband service options provided by alternative cable modem, satellite and wireless technologies. Our interest is in encouraging the availability of affordable broadband services to California consumers. Until such time that comparatively affordable, competitive broadband alternatives are widely available to residential consumers, line sharing should continue to be offered as a UNE. The excerpts from our comments filed at the FCC cited above, are included, not in an attempt to meet the FCC's necessary and impair test (which we agree does not apply to the states), but to give the current status of the broadband market in California.

AT&T asserts that Pacific's claim, in its comments on the RDD, that there is no record evidence to meet the "necessary and impair" test is simply irrelevant, since this Commission is not bound by the FCC's "necessary and impair" test. We concur with AT&T's conclusion that this Commission is not bound by the necessary and impair test.

In California, § 709.7 of the P.U. Code is a clear indication of state policy that directs the CPUC to promote line sharing. In 1999 when that section was added to the P.U. Code, the technical feasibility of line sharing was in question, unlike today when CLECs are providing broadband service to one million Californians in line sharing arrangements with the ILECs. In 1999, the FCC was still evaluating line sharing, and had not yet issued a final order. The Legislature ordered the Commission to participate in the FCC's proceeding, and indicated that if the FCC did not act before January 1, 2000:

> …the Public Utilities Commission shall expeditiously examine the technical, operational, economic, and policy implications of interconnection as described in subdivision (b) and, if the Public Utilities Commission determines it to be appropriate, adopt rules to require incumbent local exchange carriers in this state to permit competitive local exchange carriers to provide high bandwidth data services over telephone lines with voice services provided by incumbent local exchange carriers. (P U Code § 709.7(c).)

Unless it is demonstrated that such policy is inconsistent with, or substantially prevents implementation of the requirements of the 1996 Act, the CPUC regulations promoting line sharing shall be enforced. In enacting § 709.7, the Legislature made it clear that CLECs should have access to line shared loops, and this Commission has an obligation to follow the legislative dictate to ensure that that HFPL is available to CLECs.

The ILECs would have us put this proceeding on hold, pending the outcome of the D.C. Circuit decision. We are not willing to do that. Parties and the Commission have invested significant time and effort in developing this record to enable us to adopt permanent prices for the HFPL, and to resolve some outstanding issues from the line sharing arbitration proceeding. Consistent with §§ 261(b) and (c) of the Act, and given the state's independent authority under Pub. Util. Code § 709.7 and that section's mandate, we have the authority to require line sharing and to set permanent rates for the line-sharing UNE. We exert that authority here and order that ILECs will continue to offer the line sharing UNE, and we adopt permanent prices for the HFPL in California.

4. The Appropriate Charge for Use of the High Frequency Portion of the Loop is $0

4.1. Parties' Positions

4.1.1. Rhythms' Links, Inc.'s (Rhythms) Position

Rhythms asserts that there should be no charge for the HFPL. According to Rhythms virtually all states except California have established a $0 price for the HFPL, having determined that a $0 price complies with pertinent FCC pricing rules and reflects sound economic and regulatory policy. A $0 price is both cost-based and nondiscriminatory. Furthermore, it reflects the pricing decision that Pacific and Verizon voluntarily made for their own Asymmetric Digital Subscriber Line (ADSL) services.

Pacific and Verizon incur no economic cost when the ILEC, or its affiliate, uses the HFPL to provide line-shared DSL services. In contrast, a positive price for the HFPL requires other competitors to incur a real and direct cost.

In the Line Sharing Order, the FCC set forth a simple prescription for establishing a price for line sharing:

> We conclude that, in arbitrations and in setting interim prices, states may require that incumbent LECs charge no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services. This is a straightforward and practical approach for establishing rates consistent with the general pro-competitive purpose underlying the TELRIC principles. We find that establishing the TELRIC of the shared line in this manner does not violate the prohibition of section 51.505(d)(1) of our rules against considering embedded cost in the calculation of the

> forward looking economic cost of an unbundled network element.[17]

Rhythms points out that Pacific and Verizon in their federal ADSL cost studies did not assign any loop costs to their retail ADSL service. In its Federal filing Pacific stated that no additional loop cost was incurred by the provision of ADSL on an existing voice line, arguing that:

> Several petitioners contend that Pacific must assign outside plant (local loop) costs to its ADSL service. But Commission rules impose no such requirement. FCC Rule 61.38 requires LECs to identify the direct cost to provide the proposed new service. Pacific proposes to transmit ADSL over loops already in service. Pacific already recovers the costs of those local loops under tariffs already approved by the Commission and state regulators. Loop costs therefore contribute nothing to the direct cost of ADSL service.[18]

Verizon has made similar attestations. Verizon's predecessor GTE has stated:

> [s]ince ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates…. [19]

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[17] Line Sharing Order, ¶ 139 (footnotes omitted).

[18] Rhythms citing Reply of Pacific Bell, In the Matter of Pacific Bell, Pacific Tariff FCC No. 128, Transmittal No. 1986, Pacific's ADSL Service, (June 26, 1998) at 15 (footnotes omitted). Rhythms omitted some of the key language from Pacific's filing. The quote included in this order reflects the language of Pacific's actual filing.

[19] Rhythms citing GTE's Reply, In the Matter of GTE Telephone Operating Companies Tariff FCC No. 1, Transmittal No. 1148, May 28, 1998, at 18 (footnote omitted).

Rhythms asserts that Pacific and Verizon advocated a zero cost for use of the HFPL when there were no competitive issues involved. However, now that the ILECs are obligated to provide the HFPL unbundled network element (UNE) to other carriers, they have changed their position.

4.1.2 TURN's Position

TURN lists three reasons why there should be a monthly recurring charge for the HFPL: 1) consistency with the outcome in the Interim Line Sharing Phase, 2) requirements of TA96 § 254(k); and 3) economically correct outcome.

According to TURN, the Commission has already spoken on the threshold question of whether there should be a monthly recurring charge for the HFPL. In its Interim Opinion, affirming the results of the May 20, 2000 Final Arbitrator's Report (FAR), the Commission rejected the proposed zero monthly rate for the HFPL and stated that "…a zero monthly rate is not in the public interest, convenience, and necessity, and we reject a zero monthly rate in the interim." (Interim Opinion, D.00-09-074, September 21, 2000 at 11.) TURN recommends that the Commission reaffirm the outcome reached in its Interim Opinion.

TURN asserts that a monthly recurring charge for the HFPL UNE is necessary to satisfy the requirements of Section 254(k) of TA 96. Section 254(k) reads as follows:

> SUBSIDY OF COMPETITIVE SERVICES PROHIBITED.— A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of

> universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

In a line sharing context, the loop is clearly a shared facility of both voice grade local exchange service and DSL service. And in a line-sharing context, the cost of a copper loop is a shared cost of both voice grade local exchange service (utilizing the low frequency portion of the loop), and Digital Subscriber Line (DSL) service (utilizing the high frequency portion of the loop). TURN states that the FAR in the Interim Line Sharing Phase, which was adopted by the Commission, cited the provisions of 254(k) as one justification for establishing a monthly recurring charge for the HFPL.

According to TURN, the second sentence in § 254(k) must be of concern in this proceeding. The loop is a shared cost of the HFPL UNE and local exchange service, which is the service comprising universal service. It is neither reasonable or lawful for local exchange service to bear the shared cost of the loop, while the HFPL UNE bears no portion of the shared cost. To avoid having universal service bear more than "a reasonable share of the joint and common costs of facilities used to provide both of these services," some portion of the shared costs must be allocated to the HFPL UNE.

> TURN's third reason for adopting a monthly recurring charge for the HFPL UNE is that it is economically sound to do so. TURN, ORA, Pacific and Verizon all agree that the HFPL has value and a price should be set for its sale to other carriers.

TURN also urges that the Commission's determination on the threshold issue of whether a monthly recurring charge should be assessed for the HFPL UNE should also apply to line sharing over fiber-fed loops in a next-generation digital loop carrier (NGDLC) network architecture, such as Pacific's Project Pronto.

TURN proposes monthly recurring rates for the HFPL UNE of $2.0025 for Pacific and $2.3175 for Verizon. According to TURN, the first issue to be addressed is what cost information the Commission should rely on in setting a reasonable monthly recurring charge for the HFPL UNE. Pacific's loop cost studies are based on 1994 data, and the Commission is currently reexamining those costs in its UNE Reexamination Proceeding.[20] Verizon presents a special problem because there are no approved cost studies for Verizon in California.

TURN's witness Dr. Roycroft used the FCC's Hybrid Cost Proxy Model (HCPM) that the FCC used to determine the cost of telephone loops for the purpose of calculating the amount of federal funding for universal telephone service provided to all ILECs, including Pacific and Verizon. The HCPM model yielded loop costs of $8.01 for Pacific and $9.27 for Verizon. According to TURN, the FCC's cost information provides a publicly available, reasonable, unbiased, and current basis for use in setting prices.

The second step, TURN states, is to determine a reasonable price for the HFPL UNE. Since the loop is a shared facility of DSL and other services--including local exchange service, vertical features, and toll service--the loop costs cannot be attributed to the production of any single service or product. TURN's witness Roycroft developed his recommended prices using an economic allocation tool known as the Shapley Value. The allocation that results is viewed by researchers to be fair and equitable. Also, the method ensures that the allocation components will always add up to the total cost associated with the

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[20] A.01-02-024 / A.01-02-035 / A.01-02-034.

shared facility. Also, the application of the Shapley Value is a very straightforward process that can easily be utilized in the future if prices need to be adjusted.

The Shapley Value method addresses the problem of recovering the cost of a shared facility by identifying possible groupings of service offerings that share facilities and assigning unbiased probabilities of each grouping utilizing the shared facility in all possible combinations with other services. According to TURN, the existence of these services was relied upon in TURN's effort to determine what portion of the shared loop costs should be borne by the new HFPL UNE product. TURN allocates the loop costs to four families of services: basic exchange service, toll / access, vertical services, and advanced services, and recommends setting rates at 25% of the total loop costs that result from application of the HCPM model, or $2.0025 for Pacific and $2.3175 for Verizon.

4.1.3 ORA's Position

ORA concurs with the finding in the FAR in the Interim Line Sharing Phase that there cannot be an "allocation of zero common cost, zero cost of capital, and zero economic depreciation for the HFPL." (FAR at 65.) As ORA's witness Dr. Johnston stated in his testimony, it would be unreasonable for services that use the loop to escape contribution to collect the cost of the loop. New services over the loops should contribute their share of recovery to loop costs.

ORA asserts that the charge for use of the HFPL must be cost-based. As Johnston explained in his testimony, if the HFPL is not cost-based, it poses significant risks to ratepayers as new digital services replace analog. Thus, if the logic of the interim pricing is continued—that is, adding charges to the unbundled loop for new services such as HFPL instead of allocating use of the HFPL as a portion of the unbundled loop charge—the residual voice servicesdriven costs of the loop would remain unchanged and the new costs, ascribed to high-bandwidth services riding the copper, would be added to voice charges. Moreover, even as loop costs were going down for the ILEC, since digital services are more cost-effective than analog, the loop price would be going up.

4.1.4 Pacific's Position

Pacific's witness Dr. Fitzsimmons states, "The overriding principle for determining the portion of the shared loop cost to allocate for recovery by the price of the HFPL is that this allocation should allow for a competitive outcome to the greatest possible extent." (Fitzsimmons for Pacific, Opening Testimony at 16.) In a competitive market, a company would not give away a product, such as the HFPL, without expecting something in return. This principle is especially true when to do so would preclude the use of that asset by its owner, as is the case with the HFPL.

Pacific rebuts Rhythms' contention that the price for access to the HFPL should be zero, saying that Rhythms' price proposal would basically require Pacific to subsidize Rhythms' service offerings. According to Pacific, this subsidization is harmful to competition and is financially unfair to Pacific.

Rhythms refers to the following FCC statement to support its demand for a zero price for access to the HFPL:

> States may require that incumbent LECs charge no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services.[21]

[21] Line Sharing Order ¶ 139.

Pacific points out that the FCC's language is permissive, not mandatory; it states what the Commission may do, not what it must do. According to Pacific, Rhythms misses the real point of the FCC's statement. The point the FCC was making is that whatever price is chosen for access to the HFPL, it should not place CLECs at a disadvantage compared to an ILEC's offering of DSL services. According to Pacific the crucial point is that Pacific will not be providing retail DSL service to end-users. Retail DSL service is provided by ASI, a separate affiliate. As applied to this case, the FCC's pricing suggestion means that the price CLECs pay for the HFPL should be the same as the price ASI pays for HFPL.

While Pacific's and TURN's economists agree that the HFPL and the low frequency portion of the loop are joint products, Rhythms characterizes the HFPL as an "enhancement" to the loop. Pacific's witness Dr. Fitzsimmons rebuts that characterization, saying "[f]or over 100 years, economists have recognized that multiple outputs created by the same process are joint products, and the costs of producing the outputs are joint costs." (Fitzsimmons for Pacific, Rebuttal Testimony at 6.) The high and low frequency ranges on a loop are produced in the same process of constructing that loop.

Pacific rebuts Rhythms argument that a positive price for the HFPL is a violation of the principles the Commission established in the New Regulatory Framework (NRF) proceeding. Rhythms attempts to argue that the HFPL is not an innovative new product that Pacific developed, but instead is a new profit center for Pacific. According to Pacific, Rhythms is mistaken. The HFPL is precisely the type of product to which NRF was intended to apply.

Pacific proposes that the Commission retain the $5.85 price for access to the HFPL that was adopted in the interim line sharing arbitration and take the opportunity to utilize these funds to help offset the shortfall in the cost of providing basic residential service.

Pacific states that in its Line Sharing Order, the FCC declared that one loop can actually comprise dedicated connections from a single customer to two different service providers—one providing the customer with voice service, and the other with data service. Either connection, on its own, requires the loop, and none of the loop costs on the shared line are attributable to only one of the two connections. Consequently, standard TELRIC methodology, which was designed for estimating direct costs, is not applicable to pricing access to the HFPL.

According to Pacific, the FCC and this Commission have offered some guidance on the appropriate means of allocating loop costs on a shared line. One of the most fundamental principles of costing recognized by this Commission is the concept of "cost causation." As described in the Commission's Consensus Costing Principles, "Principle No. 2: Cost causation is a key concept in incremental costing…The basic principle of cost causation is that only those costs that are caused by a cost object in the long run should be directly attributable to that cost object." (D.95-12-016, Appendix C.) As described above, the single copper loop can provide both a dedicated voice connection and a simultaneous dedicated data connection. Either connection, on its own, requires the loop, and on a shared line, the two dedicated connections jointly cause the cost of the loop. Consequently, pursuant to this Commission's Consensus Costing Principles, allocation of costs to both the high-and low-frequency portions of the loop is appropriate.

According to Pacific, consumers have several options available if they wish to obtain high-speed access to the Internet. They may purchase DSL service, or they may choose broadband wireless, cable or satellite technologies.

This Commission needs to bear in mind what impact an artificially low price for access to the HFPL would have on the broadband market in general.

Pacific states that the Commission should also consider the pro-competitive effect that a $5.85 price for access to the HFPL has had—and will continue to have—on the DSL market. If CLECs have to purchase an entire loop from Pacific, they would pay $11.70. Currently with line sharing, CLECs can purchase just the high frequency portion of that loop at an even more substantial discount—50 percent off the current loop price—down to $5.85. According to Pacific, this clearly provides a significant incentive for CLECs to enter the residential market and offer attractive prices.

Pacific's witness Dr. Fitzsimmons asserts that setting the price for access to the HFPL at 50% of the price of the unbundled loop will make a reasonable contribution to joint loop costs. The $5.85 price has been in effect for several months, and during that time CLECs have purchased increasing volumes of line-shared loops. Pacific sees that that price is spurring deployment of advanced services.

Additionally, the HFPL is an appropriate source of contribution to the shortfall that currently exists in the provision of basic services. The Commission has in the past relied on Pacific's above-cost services to contribute to Pacific's losses incurred in the provision of basic service. The Commission's New Regulatory Framework (NRF) under which the Commission placed both Pacific and Verizon several years ago, does not guarantee Pacific price increases for basic service if it loses market share for those above-cost services. Instead, under NRF, Pacific's challenge is to increase its efficiency and introduce profitable new services.

4.1.5 Verizon's Position

Verizon supports the Commission's determination in the interim phase of this proceeding that a zero price for the HFPL was not appropriate. The arbitrator considered and rejected the detailed testimony regarding why the price for the HFPL should be zero. The arguments for why the price should be zero that were rejected in the interim phase are essentially the same arguments presented in this permanent phase.

Verizon rebuts Rhythms' contention that a positive price provides an implicit subsidy toward other services. The basis of this argument is that such a price recovers no cost attributable to the HFPL. However, as Verizon contends, the price for the HFPL does recover real costs not directly related to other services. Moreover, the logical result of Rhythms' argument is that allowing CLECs to provide DSL service without contributing to common cost recovery would implicitly subsidize those DSL services.

Also, contrary to Rhythms' claims, Verizon asserts that a positive price does not unfairly discriminate against customers who subscribe to line-shared DSL services. All DSL providers would pay this price, including Verizon's separate data affiliate, Verizon Advanced Data Inc. (VADI). Rhythms is wrong when it argues that requiring VADI to pay its fair share of Verizon's common costs simply constitutes a shift of revenue from one pocket of the same corporate pants to another. Rhythms' analysis fails to recognize that all DSL providers face intense competition for high speed internet access customers from other sources, such as cable modem providers. Verizon is very aware that every charge imposed on VADI will increase VADI's costs to provide DSL services, affecting its ability to compete.

Verizon asserts that there are direct costs associated with providing the HFPL UNE. Only by investigating this cost as compared to the cost of unbundled POTS (Plain Old Telephone Service) loops can the appropriate cost-based HFPL share be determined. Until this matter is resolved in the costing phase, Verizon recommends that the interim rate of $3.00 per month be continued.

Verizon states that in the interim phase, the company had not identified any incremental loop costs caused by providing the HFPL over home-run copper loops,[22] and consequently did not propose a positive price for the HFPL. Since that time, Verizon has identified "embedded constraint" incremental costs associated with providing the HFPL over copper loops. Providing the HFPL over home-run copper loops will take place on Verizon's existing network, which has many copper loops that are 12-16 kft in length. In a forward-looking environment, those same loops may well be converted to hybrid fiber / copper loops. If Verizon is providing the HFPL on the existing all-copper loop, it cannot efficiently introduce fiber into this loop or convert that customer to a hybrid fiber / copper loop.

4.1.6 Discussion

We begin our discussion of the proper price for the HFPL by stating that we are making a policy determination, not analyzing TELRIC cost studies or other scientific data to determine the HFPL price. We point to the assigned ALJ's Ruling of July 19, 2001, which denied Rhythms' motion to strike testimony filed by other parties. Rhythms asserted that TURN's witness Roycroft's testimony exceeded the defined scope of the HFPL pricing phase. According to Rhythms, the discussion at the May 2, 2001 PHC made it clear that such testimony was not

[22] Home-run copper loops are those loops totally composed of copper facilities, from the customer's premise to the Central Office.

to include cost studies reexamining the underlying loop rates, but was to be limited only to a discussion of whether any portion of the already existing UNE loop rate should be allocated to CLECs' use of the HFPL for DSL service.

In ruling on Rhythms' motion to strike, the assigned ALJ concluded as follows:

> Rhythms has taken much too narrow a view of the scope of the HFPL proceeding. While other parties agree that this is a policy issue, they are not precluded from submitting cost data which serves as the basis for their policy positions.

We reiterate that we are making a policy decision on the proper charge for the HFPL, based on the record evidence presented in this proceeding. We do not purport to base our adopted rate on a detailed cost study for the HFPL.

As a starting point, we need to examine the language in the FCC's Line Sharing Order. Both Rhythms and Pacific have cited paragraph 139 from the order to support their position. A careful reading of that paragraph shows that Pacific's interpretation is correct. The FCC's language is permissive when it indicates that states "*may*" require that ILECs charge no more than the amount of loop costs allocated to ADSL services when the ILECs established their interstate retail rates for the service.

In addition, in paragraph 139, the FCC limits its statement to apply to "arbitrations and in setting interim prices." The FCC is silent on the setting of permanent HFPL prices, which is what we are doing in this proceeding. However, while the FCC's language in ¶ 139 is permissive, the FCC's rules clearly allow states to set a rate of $0 for the HFPL. And as Rhythms points out, a number of states have adopted a $0 rate for the HFPL UNE.

Also, we find the FCC's argument that the ILECs are currently recovering the full cost of the loop—including the HFPL portion—a compelling reason to set the HFPL rate at $0. In paragraph 140 of its Line Sharing Order, the FCC states:

> We find it reasonable to presume that the costs attributed by LECs in the interstate tariff filings to the high-frequency portion of the loop cover the incremental costs of providing xDSL on a loop already in use for voice services. Under the price cap rules for new access services, the recurring charges for such services may not be set below the direct costs of providing the service, which are comparable to incremental costs. The rates the incumbent LECs set for their special access xDSL services should cover those costs. The incumbent LECs filed their cost support for their own special access DSL services before we issued the notice giving rise to this Order compelling line sharing, and they have defended their cost support when challenged in petitions to reject or suspend their tariff filings. Since the incremental loop cost of the high-frequency portion of the loop should be similar to the incremental loop cost of the incumbent LEC's xDSL special access service, this approach should result in the recovery of the incremental loop cost of the high-frequency portion of the loop.[23]

Both Pacific and Verizon asserted in their filings at the FCC when they filed for authority to offer ADSL service that they were recovering the full cost of the loop from existing services. In its June 26, 1998 reply filing at the FCC, Pacific asserts as follows:

> Several petitioners contend that Pacific must assign outside plant (local loop) costs to its ADSL service. But Commission rules impose no such requirement. FCC

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[23] Id., § 140.

> Rule 61.38 requires LECs to identify the direct cost to provide the proposed new service. Pacific proposes to transmit ADSL over loops already in service. Pacific already recovers the costs of those local loops under tariffs already approved by the Commission and state regulators. Loop costs therefore contribute nothing to the direct cost of ADSL service.[24]

Pacific made a similar statement in responding to protests to its filing at this Commission of an intrastate ADSL tariff:

> Protestants fail to come to grips with the fact that Pacific Bell's retail end users already pay the Commission-approved and FCC approved prices that recover the cost of the copper loop over which the ADSL service is placed.[25]

Verizon has made similar attestations. Verizon's predecessor GTE has stated:

> [s]ince ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates.... [26]

The ILECs have stated to both this Commission and the FCC that they recover the cost of the loop through tariffed services. They made that statement at a time when it was to their benefit <u>not</u> to allocate any costs to the high frequency portion of the loop, and there were no competitors using those

[24] Reply of Pacific Bell, In the Matter of Pacific Bell, Pacific Tariff FCC No. 128, Transmittal No. 1986, Pacific's ADSL Service, (June 26, 1998) at 15 (footnotes omitted

[25] Letter from Isabelle M. Salgado, Senior Counsel, Pacific Telesis Legal Group, Re: Response to Protests Regarding Pacific Bell's Advice Letter 19543 (August 4, 1998).

[26] GTE's Reply, In the Matter of GTE Telephone Operating Companies Tariff FCC No. 1, Transmittal No. 1148, May 28, 1998, at 18 (footnote omitted).

line-shared loops. We do not find convincing their more recent assertions that they do not recover the costs of the loop from their tariffed services. Further, since the ILECs recover the cost of the loop from tariffed services, we are justified in setting a $0 rate for the HFPL.

Next we examine the issue of the need to be consistent with the outcomes in our ILS decision. In Ordering Paragraph 2(a) in that decision, we made it clear that the line sharing proceeding would remain open to determine "final prices, including the issues of double recovery of loop costs and disposition of balances in memoranda accounts." In other words, we anticipated that final prices could differ from those adopted on an interim basis, and we are not constrained by the outcomes we adopted in the interim phase of this proceeding. We have developed a more robust record in this proceeding than is generally possible in the expedited arbitration process, which will allow us to set permanent rates. While we may endorse some or all of our earlier rulings in D.00-09-074, we are not required to do so.

TURN has raised the issue of the need to satisfy the requirements of §254(k) of TA96, and we need to address TURN's concerns relating to the second sentence of that section. Shared and common costs are fixed relative to a specific TELRIC-based denominator. In other words, shared and common costs of a UNE loop do not vary with the addition of new UNE features or uses. Accordingly, there are no "additional" joint and common costs that "voice customers" are paying and "DSL customers" are avoiding.

In its Reply Comments on the RDD, WorldCom states that even a $0 HFPL would not create an improper subsidy from local exchange service to DSL. According to WorldCom, the definition of a subsidy is a price set below the economic cost of providing a service—quantified as incremental cost. As discussed above, the weight of the evidence in the record of this proceeding conclusively demonstrates that the incremental cost of using the HFPL is $0. Thus, setting the HFPL charge at $0 cannot be a subsidy because use of the HFPL generates $0 incremental costs.

Further, WorldCom asserts that the HFPL is not a joint product with analog voice service, and thus causes no loop-related costs. The FCC explicitly noted that line sharing is not available to provide DSL-based service to a person who does not subscribe to basic exchange service, and that a different UNE, the loop element, has already been defined to fulfill that purpose. Because the stand-alone loop element is already available to service customers not subscribing to basic exchange service from the incumbent, it is implausible to suggest that line sharing could be defined as anything but an adjunct, or an enhancement, to basic exchange service. Regarding these two arrangements as joint products would only be correct if they were equally available on a stand-alone basis, which they are not.

We concur with WorldCom's reasoning on this issue and conclude that a $0 price for the HFPL does not violate § 254(k).

Pacific proposes a rate of $5.85 for the HFPL, and suggests that that amount will assist Pacific in making up some of the shortfall associated with providing residential basic exchange service.[27] In this case we are pricing the HFPL as a UNE and must follow the FCC's rules for pricing UNEs. CFR Rule

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[27] We disagree with Pacific's basic premise that there is a shortfall associated with providing residential basic exchange service. In 1996 we created an explicit subsidy system in the CHCF-B to subsidize residential loops in high-cost areas, and eliminated the implicit subsidies needed to support residential basic exchange service. The Cost Proxy Model adopted in D.96-10-066 was used to estimate the cost of providing residential basic service and determined the amount of subsidy needed for providing universal service. Pacific, and other ILECs, are entitled to subsidy support for those high-cost Census Block Groups.

51.505(d) lists the factors that may not be considered in calculation of the forward-looking economic cost of a network element. Subsection (4) reads as follows:

> Revenues to subsidize other services. Revenues to subsidize other services include revenues associated with elements or telecommunications service offerings other than the element for which a rate is being established.

We find that Pacific's proposal to collect $5.85 or 50% of our adopted loop rate violates Rule 51.505(d)(4), which bars states from setting UNE rates which include revenues to subsidize other services, which is precisely what Pacific is proposing. While the Commission in the past has relied on above-cost services to subsidize below-cost services, that sort of cross-subsidization is not appropriate in the pricing of UNEs.

Nor do we agree with Pacific's argument that the CLECs are lucky to pay only $5.85, because if they have to purchase the entire loop, they would pay $11.70. This argument is spurious because CLECs who utilize the HFPL are competing with Pacific's separate affiliate ASI, which supplies service over line-shared loops. It is not economically feasible for a competitor to pay $11.70, and then attempt to compete against ASI with its lower loop cost.

Next we examine Verizon's proposal that the current $3.00 HFPL rate which was adopted in the Interim phase be continued until final pricing. Verizon has the mistaken impression that this phase of the PLS proceeding is scheduled to address only the policy issue of whether there should be a positive price for the HFPL, not what that price should be. Verizon is mistaken. This phase of the PLS proceeding is scheduled to set a permanent price for the HFPL, to replace the interim rates adopted in the Interim Line Sharing phase in D.00-09-074. At the PHC on May 2, 2001 in the PLS proceeding, Rhythms counsel indicated that this phase is to determine "on a permanent basis what the monthly loop recurring price should be, if any, for the HFPL."[28] The assigned ALJ cited this section from the transcript in her July 19, 2001 Ruling denying Rhythms' motion to strike certain testimony filed by other parties. This phase of the PLS proceeding will set the permanent HFPL rate; that issue is not scheduled to be addressed further in the costing phase of this proceeding.

Verizon indicates that in the costing phase, it intends to propose a rate of $7.32 based on what it terms its "embedded constraint" theory. Since this represents Verizon's proposal for a permanent HFPL rate, we will examine Verizon's proposal here. As Rhythms and ORA point out, Verizon's proposal to recover the costs of retaining its home-run copper network to provide HFPL to customers since it cannot efficiently introduce fiber into a loop or convert that customer to a hybrid fiber / copper loop, violates the FCC's rules on factors that may not be considered in pricing unbundled network elements. CFR Rule 51.505(d) (1) reads as follows:

> Embedded costs. Embedded costs are the costs that the incumbent LEC incurred in the past and that are recovered in the incumbent LEC's books of accounts.

Verizon's investment in its copper network clearly fits in this category of embedded costs that cannot be considered in setting a price for UNEs. Verizon's embedded constraint theory violates CFR 51.505(d)(1). We reject Verizon's proposal for setting a permanent HFPL rate of $7.32.

TURN proposes an allocation of 25% based on the Shapley Value, based on the theory that four major services utilize the loop: basic exchange

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[28] RT at 1491, Prehearing Conference in Permanent Line Sharing Phase of OANAD, May 2, 2001.

service, toll / access, vertical services, and the HFPL. Rhythms criticizes TURN’s allocation saying that there are many other services that utilize the loop, including 911, 800 and 976 services, directory assistance and operator services. We concur with Rhythms that other services also use the loop, and are troubled that the Shapley Value is arbitrary in allocating the same percentage to the four uses of the loop that TURN identifies. TURN's proposal is inconsistent with application of the Shapley Values as their proposal results in misallocated prices to the purported four services that exceed shared loop costs. Further, TURN's refund proposal does not correct the fact that prices would exceed the cost of the loop and therefore create an uneconomic and arbitrary pricing signal to the market.

We believe that the correct outcome is to have a $0 price for access to the HFPL because HFPL is additive, having no specific cost. A rate of $0 also addresses the issue of potential discrimination that parties raised in their comments on the DD. In its comments on the RDD, AT&T states that the provision of high-speed data services is an ever-increasing part of the total package of services that competitors, and now ILECs, will provide end users. With integration of the ILECs’ data affiliates, it is important for the Commission to consider safeguards against anticompetitive behavior on the part of Pacific and Verizon. A $0 rate ensures that ILECs and CLECs have a level playing field if / when the ILEC’s data affiliate is reabsorbed into the ILEC’s operations. Otherwise, the unaffiliated CLEC would have to pay for the HFPL, and the ILEC itself would not.

TURN urges that the Commission’s determination on the threshold issue of whether a monthly recurring charge should be assessed for the HFPL UNE should also apply to line sharing over fiber-fed loops in a Next Generation Digital Loop Carrier(NGDLC) network architecture. We believe that it should.

This determination is in accordance with an ALJ Ruling issued July 17, 2001, which includes the following statement:

> The ALJ also indicated at the PHC [Prehearing Conference] that this first sub-phase would also include testimony regarding the policy question of whether there should be a monthly recurring price for fiber-fed DLC loops. At the same time, the ALJ further indicated that the pricing question of how much that price (if any) should be would be reserved to the second sub-phase (non-costing and NGDLC interim pricing phase). (ALJ Ruling at 4.)

This ruling makes it clear that the policy issue of whether there should be a charge associated with the HFPL UNE over fiber-fed loops is within the scope of this proceeding. Without prejudicing any future decisions we may make regarding unbundling of NGDLC loops, we confirm that there should be a $0 price for the monthly recurring access to fiber-fed DLC loops.

5. True-up and Treatment of Balances in Memoranda Accounts

The FAR adopted in the ILS Interim Opinion ordered Pacific and GTE (now Verizon) each to maintain a memorandum account to record revenues from the monthly recurring charge for access to the HFPL. The FAR also held that the memorandum account would be subject to interest, either by the application of interest on the balance, or the application of interest on any amounts later subject to true-up adjustments. (FAR at OP 8.)

In the FAR in our interim line sharing phase, we indicated that the amounts in the memoranda accounts would be subject to true-up. The purpose of a true-up is to reimburse carriers for overcharges or undercharges in the amount charged for the HFPL between the time the interim rates went into effect, and the implementation of permanent rates adopted in this decision. In this decision, we adopt a $0 HFPL rate for Pacific and Verizon, while the interim rates were $5.85 and $3.00, respectively. Pacific and Verizon shall reimburse carriers (including their respective affiliates, ASI and VADI) which purchased the HFPL over the past several months since the interim rates went into effect with $5.85 and $3.00 per month / per line, respectively, including interest. In its comments on the RDD, Pacific proposes that the three-month commercial paper interest rate be used; we concur with Pacific's proposal.

Parties were put on notice in the ILS phase of the possibility of a true-up,[29] and in its Line Sharing Order, the FCC acknowledged that states might need to issue interim arbitration awards, subject to a true-up:

> In addition, as explained in more detail below, we strongly encourage the states of issue interim arbitration awards setting out the necessary rates, terms, and conditions for access to this unbundled network element, with any unresolved issues subject to a true-up when the state commission completes its arbitration.[30]

Returning the money to CLECs that purchased the HFPL will bring the balance in the memorandum accounts to zero. Since we are adopting a $0 rate for the HFPL in this decision, there will be no further need for the memorandum accounts.

The RDD proposed to return the revenues to CLECs, for return to their end-use customers. This prompted comments from Speakeasy et al., a group of Internet Service Providers (ISPs), that filed a motion to intervene in the proceeding. We have changed the refund mechanism from that in the RDD, and

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[29] Final Arbitrator's Report, Ordering Paragraph 8 states: "The memorandum account shall be subject to interest, either by the application of interest on balance, or the application of interest on any amounts later subject to true-up adjustment."

[30] Line Sharing Order ¶ 160.

under this decision, the CLECs that purchased the HFPL will receive the refunds. Therefore, there is no need to grant the ISPs' request.

6. Limited Exogenous (LE) Factor Treatment

In their comments on the DD, Pacific and Verizon both assert that the administrative costs associated with any HFPL refund meet the criteria for LE Factor recovery under our NRF framework. Pacific states that in D.98-10-026, the Commission established rules for carriers seeking recovery of costs incurred as a result of Commission mandates. Pursuant to that decision, those costs would be recovered through an LE factor mechanism, under which carriers must demonstrate that the requested costs meet certain specified criteria. As a prerequisite to seeking LE factor treatment, a carrier must show that an LE factor adjustment is authorized in the underlying Commission decision.

Pacific indicates that if the Commission orders it to implement the HFPL surcredit currently described in the DD, it will incur significant administrative costs. Pacific requests that the DD be modified to include language authorizing Pacific to seek LE factor recovery for costs incurred in implementing the processes ordered in the Commission's final HFPL decision.

In this decision, we do not order Pacific and Verizon to set up a process to return HFPL revenues to ratepayers. Instead, we order that the revenues be returned to the handful of CLECs that purchased the HFPL over the past several months. Since we initially ordered the ILECs to establish memorandum accounts for the HFPL revenues in the Interim phase of this proceeding, this should not be an arduous task to return the revenues to the CLECs and does not warrant LE factor treatment.

7. Comments on Alternate Decision

The alternate decision of Commissioner Brown in this matter was mailed to the parties in accordance with Pub. Util. Code Section 311(g)(1) and Rule 77.7

of the Commission's Rules of Practice and Procedure. Comments were filed on ________________.

8. Assignment of Proceeding

Carl Wood is the Assigned Commissioner and Karen Jones is the Assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. State Commissions have the authority to establish additional UNEs pursuant to § 51.317.

2. Line sharing is the only viable option for a CLEC who seeks to compete with the incumbent LEC in providing DSL service at retail.

3. Under current FCC regulations, a CLEC has no right of access to the high-speed transmission component of cable modem service, which is the functional equivalent of DSL service.

4. The FCC is silent on the rules to follow in setting of permanent HFPL prices.

5. The proper charge for the HFPL is a policy issue and is not based on a TELRIC cost study for the HFPL.

6. 47 C.F.R. § 51.505(d) lists the factors that may not be considered in calculation of the forward-looking economic cost of a network element.

7. It is not economically feasible for a competitor to pay $11.70 for a loop, and then attempt to compete against the ILEC, or its affiliate's, DSL service provided over less expensive line-shared loops.

8. This phase of the PLS proceeding is scheduled to set a permanent price for the HFPL to replace the interim rates adopted in the interim arbitration phase in D.00-09-074.

9. Pacific and Verizon asserted in their filings at the FCC that they were recovering the full cost of the loop through existing services.

10. A number of states have adopted a $0 rate for the HFPL UNE.

11. The purpose of a true-up is to reimburse carriers for overcharges or undercharges in the amount charged for the HFPL between the time the interim rates went into effect, and the effective date of the permanent rates adopted in this decision.

12. A true-up is warranted for both Pacific and Verizon because the rates adopted for Pacific in the interim phase was $5.85, and for Verizon, $3.00, while a permanent rate of $0 is being adopted in this decision.

Conclusions of Law

1. The FCC's line sharing order is not vacated, and continues to apply as a matter of law until January 2, 2003.

2. The Commission has independent authority pursuant to Pub. Util. Code § 709.7 to require line sharing and to set permanent rates for the line-sharing UNE.

3. The Act's "necessary and impair' standard that limits the FCC's unbundling rules, has no bearing on the states' authority under § 251(d)(3).

4. Section 251(d)(2) does not apply to the states; it applies only to the FCC.

5. The FCC's rules clearly allow states to set a rate of $0 for the HFPL.

6. Since the ILECs recover the cost of the loop from tariffed services, it is appropriate to set a $0 rate for the HFPL.

7. The Commission may decide to endorse all or some of the rulings in D.00-09-074, but is not required to do so, since it has developed a separate record in this proceeding.

8. A $0 price for the HFPL does not violate § 254(k).

9. Pacific's proposal to collect $5.85, or 50% of the adopted loop rate, to make up for the shortfall in residential basic exchange revenues, violates 47 C.F.R. § 51.505(d)(4).

10. Verizon's "embedded constraint" theory violates 47 C.F.R. § 51.505(d)(1).

11. Pacific and Verizon should reimburse all carriers (including their affiliates ASI and VADI, respectively) which purchased the HFPL over the past several months since the interim rates went into effect with $5.85 per month / per line (Pacific) and $3.00 per month / per line (Verizon), plus interest.

12. Interest on the revenues in the memoranda accounts should be calculated using the three-month commercial paper rate.

13. Pacific and Verizon are not authorized to request Limited Exogenous Factor treatment for the administrative costs associated with returning HFPL revenues to the carriers that purchased HFPL.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Bell Telephone Company (Pacific) and Verizon California Inc. (Verizon) shall continue to offer the High Frequency Portion of the Loop (HFPL) to Competitive Local Exchange Carriers.

2. Pacific and Verizon shall implement the rates for the HFPL adopted herein within 30 days of the effective date of this order.

3. Within 60 days of the effective date of this order, Pacific shall reimburse carriers (including its affiliate ASI) that purchased the HFPL over the past several months since the interim rates went into effect with $5.85 per month / per line, plus interest.

4. Within 60 days of the effective date of this order, Verizon shall reimburse carriers (including its affiliate VADI) that purchased the HFPL over the past several months since the interim rates went into effect with $3.00 per month / per line, plus interest.

5. The May 24, 2002 motion of Verizon California Inc. to suspend the comment period of the Draft Decision and not put the Draft Decision on the Commission's meeting agenda until further notice, is hereby denied.

6. The November 21, 2002 motion of Speakeasy, Inc; Earthlink, Inc; Sonic-Net Inc; InReach Internet LLC; DirecTV Broadband, Inc; and DSLExtreme.com to intervene in this proceeding is hereby denied.

This order is effective today.

Dated ____________________________, at San Francisco, California.

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Alternate Draft Decision of Commissioner Brown on all parties of record in this proceeding or their attorneys of record.

Dated December 5, 2002, at San Francisco, California.

/s/ VANA WHITE

Vana White

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

APPENDIX A

LIST OF APPEARANCES

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I9304002

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